1971

The Role of the Provinces in Regional Economic Development: Some Comments

Thomas J. Courchene

20303

Comments Welcome

RESEARCH REPORT 7134

THE ROLE OF THE PROVINCES IN REGIONAL ECONOMIC DEVELOPMENT: SOME COMMENTS*

by

Thomas J. Courchene**

December, 1971

*An earlier version of this paper was read to the CEA/CCRD Regional Economics Conference in Winnipeg (November 1970) as a set of comments on Carl Wenaas' study on development policies of provincial governments. While considerable effort was made to make the paper self-contained, it is probably still appropriate to treat it as an extended comment on the Wenaas paper rather than an independent contribution. I would like to thank Bob Pieklik and Ron Wirick for their suggestions and encouragement relating to the redrafting of the paper. Research and technical assistance relating to this paper were financed under a Canada Council grant.

**Professor of Economics, University of Western Ontario and, currently, research associate with the Institute of Policy Analysis, University of Toronto.

Introduction

In order to evaluate the role that the provincial governments *are* playing in regional development it is necessary first to know the role that they *ought* to be playing. An enumeration of the various provincial development programs is clearly both instructive and valuable. But without some point of reference or benchmark for comparison purposes it is difficult to extend an enumeration into an evaluation. The purpose of the comments that follow is to attempt to sketch out one possible approach in the direction of establishing a framework suitable for evaluating provincial policies in the regional development area. Establishing this framework consists essentially of seeking answers to two related questions.

1) What is Canadian economic policy attempting to do?
2) How is the responsibility for implementing these policies being allocated among the various levels of government?

In more familiar language, we must ascertain 1) the *objectives* or goals of Canadian economic policy and 2) the *strategies* employed in implementing these policy objectives. Once the objectives and strategies are known, it then becomes possible to make some progress toward suggesting the appropriate role for both provincial and federal policies and, hence, to evaluate the existing programs of these governments.

Toward this end, therefore, we shall look in turn at some alternative goals of and strategies for Canadian regional policy. Then we shall focus very briefly on some of the provincial policies and attempt an equally brief evaluation in terms of the norms generated by our conceptual framework. In setting out the various goals or *objective functions*, as we prefer to call them, focus is directed toward the national or federal level: these objective functions will be national rather than provincial objective functions. It should be clear, however, that the provincial governments will in all likelihood have a substantial impact on the formation of national goals. Once the appropriate role for national policy towards regions is decided upon, progress can be made in the direction of isolating both the strategies and types of federal and provincial policies that are consistent with the selected objective function. One implication of this approach is that it tends to make the selection of the national objective function not only the primary but as well an *independent* decision. In practice, however, this may not be the case. For example, the nature of the BNA Act may constrain the selection of the objective function. In addition, the decision about strategies (e.g., conditional vs. unconditional grants) may be taken independently of any decision relating to the selection of the objective function and may act as a further constraint on the type of regional policy objectives that can be selected for the nation. We treat these and other shortcomings and/or implications of our approach in a separate section toward the end of the paper.

II. Some Alternative Objective Functions for Canada

In Table 1 we list seven possible alternative objective functions for Canadian policy toward regions. Obviously these are meant neither to be exhaustive nor to be precisely representative of specific options, but rather to be indicative of the types of national policies open to Canada. Essentially they are numbered so that, by and large, the level of national income (in per capita terms) will fall as one moves down the list, i.e., the constraints are meant to be more and more binding as one moves from alternative 1 to alternative 7.[1] As we comment briefly on some of these objective functions it will become evident that, even without reference to the particular strategy for their implementation, different objective functions will imply different types of policies on the part of the provinces and the federal government.

---

[1] Some readers may feel that a slightly different ordering is required so that the constraints progressively become more binding. Amen!

Table 1

Alternative Objective Functions for Canada*

1. Maximize National Income.

2. Maximize National Income subject to the constraint that:

   a) there be a minimum level of income for all Canadians.

3. Maximize National Income subject to the constraint that:

   a) there be a minimum level of income for all Canadians;

   b) regional income disparities be narrowed.

4. Maximize National Income subject to the constraints:

   a) that there be a minimum level of income for all Canadians;

   b) that *provincial* income disparities be narrowed.

5. Maximize National Income subject to the constraints:

   a) that there be a minimum level of income for all Canadians;

   b) that this income be "produced" (earned) in each region.

6. Maximize National Income subject to the constraints:

   a) that there be a minimum level of income for all Canadians;

   b) that this income be "produced" in each region;

   c) that regional "production" disparities be narrowed.

7. Maximize National Income subject to the constraints:

   a) that there be a minimum level of income for all Canadians;

   b) that this income be "produced" in each province;

   c) that *provincial* "production" disparities be narrowed.

---

* We are employing the term "objective function" in quite a broad sense. In linear programming terminology, the objective function for all 7 cases enumerated above is to maximize national income and the cases differ from each other because the constraint sets differ.

Objective function #1 would require Ottawa to consider only the impact on aggregate Canadian income when designing policy. This need not imply that there would be no direct regional aspects to federal policy.[2/] However, policies with definite regional effects would have to be justified in terms of their impact on increasing national income. Since we have left unspecified whether this is a short-run or long-run maximization problem, federal intervention in providing regional infrastructure could well be consistent with maximizing Canada's income in the longer run. If the provinces adopt policies that interfere with objective #1 (e.g., discriminatory purchasing policies, competing industrial location incentives), then the level of income in Canada will, obviously, be lower than it would be if provincial policies were consistent with overall income maximization in Canada. But since the federal government under this objective function would have no *policy responsibility* for the distribution of regional income (earned or unearned) it seems to us Ottawa could be indifferent toward the actual economic policies of the provinces. Overall policy takes as one of its parameters the existing provincial policies. However, it does appear that this objective function is not acceptable to the majority of Canadians. And it would certainly be unacceptable to many of the provinces who could rightfully argue that the costs of an economic policy designed solely to maximize national output would be borne almost exclusively

---

2/ And of course there are tremendous *indirect* regional aspects to all federal policy, past and present. One only has to think of the regional implications relating to industrial location of John A. Macdonald's "National Policy" to be assured of the great regional impacts that overall federal policy can embody.

by the lagging provinces. Indeed, one can see this objective function as being relevant only for the two polar cases: a) a federation in which all power rests essentially with the junior governments and the role of the national government is primarily one of a coordinating agency or b) a virtual unitary state where the national government assumes all the power and, in addition, is not concerned about the distribution of income among its citizenry.

The second objective function incorporates an income distribution constraint and could be implemented by having Ottawa embark on some sort of guaranteed income scheme (e.g., a negative income tax). Beyond this, however, its policies would again take only the national interest into account. Again this would require little coordination between federal and provincial policies since there is no separate *regional* distribution constraint or overall policy, although some types of provincial policies would clearly lead to higher levels of national income than others.

However, the third and fourth objective functions involve the federal government directly in regional policy. One type of federal policy that might satisfy #4 would combine a guaranteed income scheme with a federal-provincial tax-equalization program of the type we are familiar with in Canada. Unlike the first two alternatives, there would now be considerable concern shown in Ottawa over policies by the provincial governments that would work *against* narrowing provincial disparities. And, one can think of many types of policies at the junior levels of government that would be inconsistent with the third and fourth objective functions -- or at the very least would require substantial counteractive federal legislation and, hence,would lessen national production. However, it is probably quite important to note that not all regional-specific legislation need be viewed as counteractive policy. For example, as a result of some national policies which do contribute to raising the nation's income some of the regions or provinces may be made worse off. In order to have such policies gain acceptance it may be necessary to effect *compensatory* (or perhaps, accommodating) legislation. Indeed, most of the "have-not" provinces currently view the federal-provincial tax-equalization scheme in this light and not as an outright interprovincial fiscal transfer.

The fifth objective function marks a real break in terms of the constraints put on national economic policy. The previous four objective functions all were consistent with having the *production* of income occur where it had the comparative advantage. Government *transfers* were sufficient (though not necessary) to satisfy the constraints in #2, #3 and #4. Not so with the fifth objective function. Here, if the constraint is binding (and surely it is), the federal government has to step in and distort resource allocation, probably by means of some sort of subsidy (e.g., wage or capital subsidy).[3/] This interference with

---

3/ This does not imply that satisfying the constraints of the previous objective functions would not involve interference with optimal resource allocation. For example, a negative income tax would affect work-leisure preferences, as would the financing of this scheme if it resulted in an increase in personal income taxes. Alternatively, financing the required transfers via an increase in corporation taxes would clearly have implications for decisions relating to both savings and investment, and so on. However, the resource re-allocation connected with say the fifth objective function in addition affects directly the location of economic activity.

resource allocation is carried much further in the sixth objective function where the additional constraint requires a narrowing of regional "production" disparities. If, to accomplish this objective, the federal government considers it essential to offer subsidies to industry to locate in certain designated areas, then competing subsidies offered at the provincial level for location in non-federally-designated areas must be considered, in terms of the objective #6, as inappropriate provincial or regional policies.

Objective function #7 introduces, in our opinion, a very serious further restriction to the maximizing of national income. It implies that the *province* rather than the region is the appropriate unit for economic development in Canada. In addition it increases considerably the possibility of conflicting policies between the two levels of government. In particular it puts restrictions on the types of policies that the richer provinces are able to pursue.

At this juncture it seems appropriate to approach these objectives within the context of a slightly different but related framework namely "people prosperity" versus "place prosperity".[4/] One view of the seven alternative objectives is that #2 to #4 increasingly regionalize people prosperity while objectives #5 to #7 increasingly regionalize both place prosperity and people prosperity. It is possible to quarrel with our interpretation of #3 and #4 as a variant of people prosperity. Our justification

---

[4/] Louis Winnick, "Place Prosperity v. People Prosperity: Welfare Consideration in the Geographical Distribution of Economic Activity" in *Essays in Urban Land Economics*, Real Estate Research Program, University of California at Los Angeles, 1966.

is that the emphasis can still be (but it need not necessarily be and, hence, the possibility arises for questioning our approach) on people and not on place as such, i.e., #4 does not necessarily imply that each province will have a viable economic base nor does it prevent factors of production (both labour and capital) from reallocating to the area in which their marginal products are greatest. Such is *not* the case for objective #7. The types of aggregate policies appropriate to objective #4 will differ vastly from (e.g., stabilization policy, manpower policy) those appropriate to #7. We shall not pursue people versus place prosperity any further in this set of comments. However, it remains a crucial issue in economic policy toward regions in Canada.

Which objective function is the most appropriate for Canada? This is a question for the Canadian people rather than the economist to decide. However, it is the economist's role to attempt to assign costs and benefits (and, in this case, especially the former) to the various alternatives. Unfortunately, not much effort has gone into work along these lines. For example we do not know what difference in Canadian GNP will result from adopting #7 rather than #1, or #7 rather than #6. But some rough personal judgements are clearly possible. We would suggest that the cost in terms of foregone national income will rise for each successive objective function. Further, we would argue that the increase in cost of going from #1 to #2 is not as large as the increase associated with moving from #6 to #7, i.e., a more or less rising marginal cost characterizes the successive objectives in Table 1.

On the benefit side, one can reasonably assume that *total* benefits rise more or less monotonically with each successive objective function. These benefits are rather difficult to identify. In part they represent direct income benefits accruing to individuals and provinces. In part they represent psychic benefits accruing to Canadians because of the knowledge that their fellow citizens are better off, i.e., they pacify the growing social conscience of the nation. In part, also, they represent the benefits accruing to the citizenry because of the increased chance that Canada will remain one nation. Our feeling (and it is no more than that) is that the greatest marginal benefit arises from moving from #1 to #2 and the second largest increase arises from going from #2 to #3 with marginal benefits positive but lower thereafter. Clearly this ranking reflects a belief that people prosperity is more important than place prosperity, even though we are eager to grant the point that place prosperity implies greater benefits (in terms of maintaining national unity) the more power is in the hands of the junior governments.[5/]

The appropriate objective function for Canada is that which generates the largest total welfare (defined as total benefits minus total costs). In more familiar terms, the appropriate policy is defined as that which has marginal benefits equal to

---

5/ Since the Canadian provinces have more powers than do the American states (relative to their respective federal governments), place prosperity will probably be more relevant for Canada than for the USA. In a unitary state, only people prosperity would appear to be relevant.

marginal costs.[6/] The important point of this benefit-cost excursion is not whether one agrees or disagrees with our casual reflections. Rather it is that we know precious little about the costs and benefits associated with moving from #1 through #7. Without such knowledge it is extremely difficult to attempt any sort of meaningful assessment of the costs and benefits of the various objective functions and, hence, to have economically rational decision-making criteria.[7/]

6/ Note that this type of analysis implies that the selection of an appropriate regional policy for Canada is really an unconstrained maximization problem rather than a linear programming problem (i.e., maximizing subject to constraints). Apart from this particular example, however, most of the analysis in this paper is of the constrained maximization type.

7/ Were sufficient knowledge and data available so that one could, for example, cast objective #7 in a linear programming context, the interpretation of the results would be quite interesting. In the objective function one would have the various possible federal policies multiplied by a given set of "prices", i.e, the contribution of each of the policies to national output. The constraint set would be a set of equations incorporating constraints (a), (b) and (c) of #7 of Table 1. The solution to the primal problem would simply be the vector of operating level of the various federal policies. The dual prices would represent the potential increase in national income that could be attained by relaxing (at unit level) the respective constraint equations. In particular, the dual prices associated with constraint set (b) would represent the increase in national income attainable by relaxing the requirement that minimum income be "produced" in each province. Assuming for the moment, that #7 was the chosen policy for Canada, then the dual prices would, in effect, reflect the opportunity cost (in term of lost output) of having provinces! Further, within the context of such a model one could evaluate the benefits in terms of increased output of moving from an objective function like #7 to one which is essentially identical but treats the Maritime region as a single province. Expressed somewhat differently, Maritime Union becomes a more critical issue when the objective function embodies provincial place prosperity (e.g., #7) than when it embodies only regional place prosperity (e.g., #6).

Nonetheless, Canada does have policies of a regional nature and it is appropriate to attempt to ascertain which, if any, of these seven objective functions current Canadian policy appears to be favouring. Given the complexity of actual policy and the generality of the goals in Table 1 the correct answer is that one cannot really match current policy with any of the seven alternatives. But with the establishment of the Department of Regional Economic Expansion, its industrial location incentives and its provincial development programs starting with Prince Edward Island, it appears Canadian policy is moving toward some version of #7. Constraint (a) of #7 has been shelved for the time being (by the recent White Paper on Income Security) but it appears that it remains a longer-run constraint on Canadian policy.[8/]

We now turn to the various strategies open to Canada for policy implementation. In viewing these alternative strategies it might be well to remember that an objective function akin to #7 is probably best representative of the thrust of current Canadian policy.

8/ On the question of income inequality in Canada, the federal government is clearly more interested in the income inequality among *provinces* than it is among Canadian *individuals*. We already have an elaborate tax equalization scheme which has recently been extended for a second five-year term (to 1977). In part this emphasis arises because jurisdiction over individual welfare falls to the provinces under the BNA Act (we shall have more to say about the division of powers in the section on strategies). For present purposes we merely point out that it is entirely conceivable for constraints (b) and (c) of objective function #7 to be satisfied without satisfying constraint set (a). In other words Canadian policy may be in the unfortunate position (again a personal viewpoint) of aiming for place prosperity <u>without</u> guaranteeing people prosperity.

III. Alternative Strategies for Regional Policy

In a unitary state, responsibility for regional development rests with the central government and there exists no policy "strategy", as we are using the term for purposes of this paper, i.e., the sharing between the federal and provincial governments of the responsibility for regional policy. But vying for responsibility between the provincial and national governments is the very essence of political federalism. In large measure this division of responsibility depends upon the particular characteristics of the federation. For example, relative to their respective central governments, the Canadian provinces have considerably more power than have the American states. In turn, this will likely imply that the provinces will have a greater say in national policy and the manner in which it is carried out than will the American states.[9] In Canada two of the major factors determining the allocation of responsibility between the provinces and the central government are the BNA Act (and judicial review over the years) and the dominant position of Ontario (and Quebec, as well) in the federation. But even given these constraints there still remains considerable scope for deciding just how much independence the provinces will have in carrying out any given policy.

The purpose of this section, then, is to investigate the various strategies open to Canada. We have already seen that the choice of objective functions has implications for the types of

---

[9] We have already argued in a footnote above that one result of this is that "place prosperity" will be more important in the Canadian context.

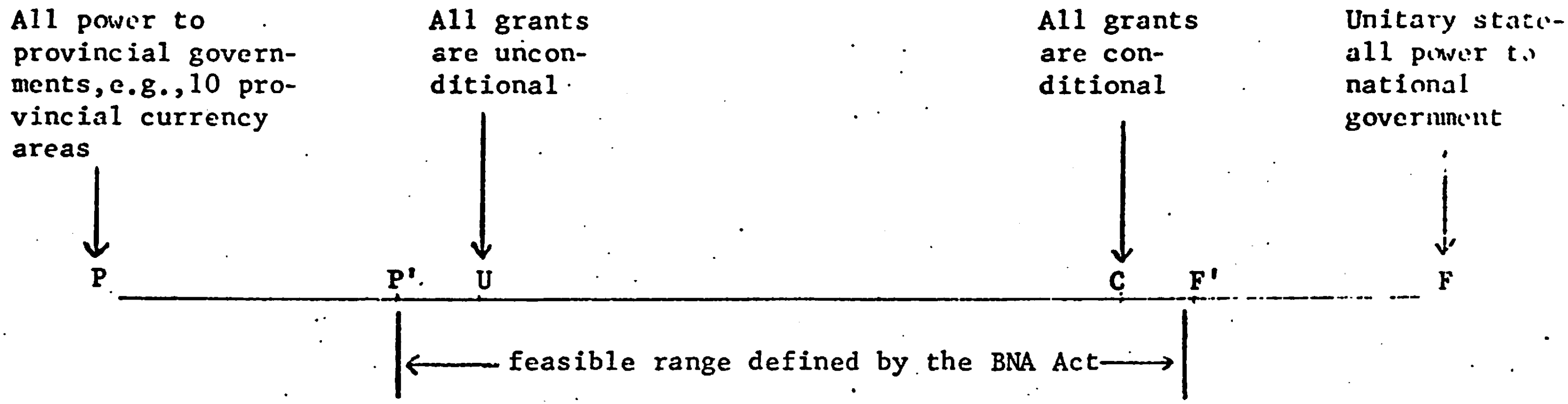
policies that are appropriate for the provinces and Ottawa. Deciding on the policy strategy will place further limits on the types of policies open to both government levels and will take us considerably closer to being able to establish a "norm" against which we can compare actual policy performance.

Toward this end, and to give the discussion a quasi-analytical bent, we refer the reader to figure 1. Point F in the stylized presentation of the provincial-federal power spectrum represents the strategy where all responsibility for policy rests with the national government. This requires a complete surrender of junior-government power and would convert the federalism into a virtual unitary state. At the other extreme all power rests with the provincial governments. This latter extreme is consistent with the adoption of *separate currency areas* for the provinces in which case they would have control over both fiscal and monetary policy.[10/]

10/ Economists have devoted considerable attention to this possibility, e.g., Robert A. Mundell, "A Theory of Optimal Currency Areas", *American Economic Review*, (September 1961), pp. 657-65.

Figure 1

Alternate Strategies for Canadian Federalism



However both these extremes are ruled out by the usual definition of a federal state. In figure 1 points P' and F' are meant to represent the feasible range imposed by the BNA Act. What determines where on the P'F' segment the division of responsibility will settle? In part it depends upon the distribution of powers in the BNA Act. Responsibility for monetary policy, for example, rests with the central government while education is the responsibility of the provincial governments. But *de facto* responsibility need not coincide with *de jure* responsibility. For example, it would be quite possible for the central bank to regionalize monetary policy (e.g., by supporting the bonds of some or all of the provincial governments) and, therefore, shift some of the responsibility for monetary policy to the provinces, i.e., move away from F' toward P'.[11/]

More interesting, perhaps, is the extent to which the central government can affect the degree of control it has over certain responsibilities assigned by the Constitution to the provinces. Because Ottawa collects a proportion of total taxes larger than its expenditure proportion, a need arises for some sort of revenue sharing between the federal government and the provinces. If these transfers are all given conditionally (e.g., matching grants) then Ottawa not only gains a measure of control

---

11/ Without attempting to render judgment on the advisability of regionalizing monetary policy, it is clear that the case for such a policy is much stronger when the objective function is one resembling #7 than when it is one like #1. This is just one of many possible examples that demonstrate the interrelationship between the selection of the objective function and the selection of the appropriate strategy for implementing the objectives.

over the specific items for which the grants are instituted but, as well, freezes an equivalent (for a 50% matching grant) amount of provincial funds so that the overall discretionary power of the provincial governments is reduced. Such a situation is represented by strategy C in figure 1.

At the other extreme, all grants could be of the unconditional variety. Equalization payments to the poorer provinces are currently of this form. This greatly increases the power of the provinces to act in their own interest and correspondingly reduces the power of the federal government. Strategy U in figure 1 is meant to correspond to the configuration where all transfers to the provinces are unconditional.

Thus far, figure 1 and the accompanying discussion does not offer much of a guide as to where along P'F' Canada *should* be. The particular objective function chosen will dictate some broad guidelines as to how the policy should be carried out. For the first objective function it seems appropriate for Ottawa, in its actions, to operate at or near F'. By means of conditional grants the federal government could force the provinces to move toward C. This would represent a "coordinated strategy" -- defined as a strategy when both levels of government are at approximately the same point on the line segment P'F'. Alternatively, the federal government could make its transfers unconditional and the provinces could remain at or near U. This would represent a "non-coordinated strategy". Either strategy would seem to be consistent with the first objective function although a coordinated strategy would surely result in a higher level of national income.

But a non-coordinated strategy (e.g., the federal government operating at C and the provinces at U) is *not* appropriate for an objective function like #7 which has implications for the relative growth of the provinces. Efficiency would be attained if both levels of government could agree to operate at a certain point along P'F' -- either by the provinces voluntarily surrendering some of their power (or the federal government inducing them to do so by means of conditional grants) and thus moving toward F' or by the federal government turning over major responsibility for regional policy to the provinces and hence moving toward P',[12/] or some of both.

At this juncture it is appropriate to raise an important issue. To what extent is the policy strategy selected (or, more correctly, bargained at various Federal-Provincial conferences) *independently* of the objective function? As Parizeau points out, unconditional grants were several times the amount of conditional grants in the latter part of the 1950's. By 1963, however, conditional grants nearly pulled even in dollar value to unconditional transfers. Since then the trend has again reverted strongly in favour of unconditional transfers.[13/] A strategy that gives major say and independence on regional policy to the provinces may

---

12/ This latter strategy would call for considerable cooperation among the various provincial governments -- cooperation of the type that we do not think has thus far existed in Canada.

13/ Jacques Parizeau, "Federal Provincial Economic Coordination", in L. H. Officer and L. B. Smith (eds.), *Canadian Economic Problems and Policies* (Toronto: McGraw Hill, 1970), pp. 85-88. Interestingly enough the trend toward conditional grants (albeit in terms of increased programs of the shared-cost type) coincided with the Diefenbaker era. In the light of Diefenbaker's rift with his party over the "deux nations" concept, this trend is what we would expect from a "centralist" leader.

well be inconsistent with a national objective function that requires narrowing of provincial production disparities. At best it is likely to be extremely costly in terms of foregone national output.

IV. An Evaluation of Canadian Regional Policy

In terms of figure 1, where can we locate Canadian regional policy?[14/] For many policies, Ottawa is locating itself near F'. This is surely the case with monetary policy. And this would appear to be the case for the location incentives offered by the Department of Regional Economic Expansion (DREE). On the other hand, Ottawa, with its current trend toward unconditional grants encourages the provinces to be at or near U. One result of this is the existence of competing incentives for industries; Wenaas' paper brings this out clearly. In addition he notes that in the case of British Columbia which does not have as complete a set of incentives as the other provinces, the federal government itself via the Industrial Development Bank has got into the act of offering competing incentives. Surely this is inconsistent policy. In part the federal government recognizes this. But its attempt to solve the inconsistency is very indirect, to say the least. One method of tackling this problem has been to build a regional component into many federal programs. Perhaps the best recent example of this is the Unemployment Insurance Act with its increased benefits for the depressed regions. Quite often, however, this sort of ad hoc approach is likely to create as many problems

---

[14/] It should be possible to classify most of Canadian regional policies in terms of figure 1. We shall deal with only one or two such policies, however.

as it solves.[15] A more direct approach has been for the federal government to enter into agreements with certain provinces to establish "development plans". This has the effect of moving these particular provinces away from U and towards C. But the richer provinces still remain at U. In order for regional incentives to work the federal government must get these other provinces to surrender some of their policy independence, i.e., move them toward C. Until this occurs federal policy is bound to be at odds with provincial policies as long as the objective function is one similar to #7 in Table 1.

As an aside, we note that it is possible that these "provincial" development plans are part of a grand design on the part of the federal government to use a combination of conditional and unconditional grants (different for each province) in order to render overall policy more efficient. For example, it is clear that the use of a conditional plus an unconditional grant can be used to force a province to be on a particular point on a given indifference curve. Consider figure 2. X and Y are the two bundles of goods purchased by the province. Let A_oB_o represent the province's existing budget line (which may already incorporate some conditional and/or unconditional grants). The province is at the optimum on indifference curve 1_o purchasing X_o of X and Y_o of Y. Suppose now that the federal government wishes to get the province to spend Y_1 on good Y and also be on indifference curve (income level) I_1, i.e., it wants the province at E_1. This is easily attainable by

[15] See T. J. Courchene, "Unemployment Insurance in Canada: Some Implications of the Present System and an Evaluation of the White Paper Proposals", Research Report 7025, University of Western Ontario, 1970.

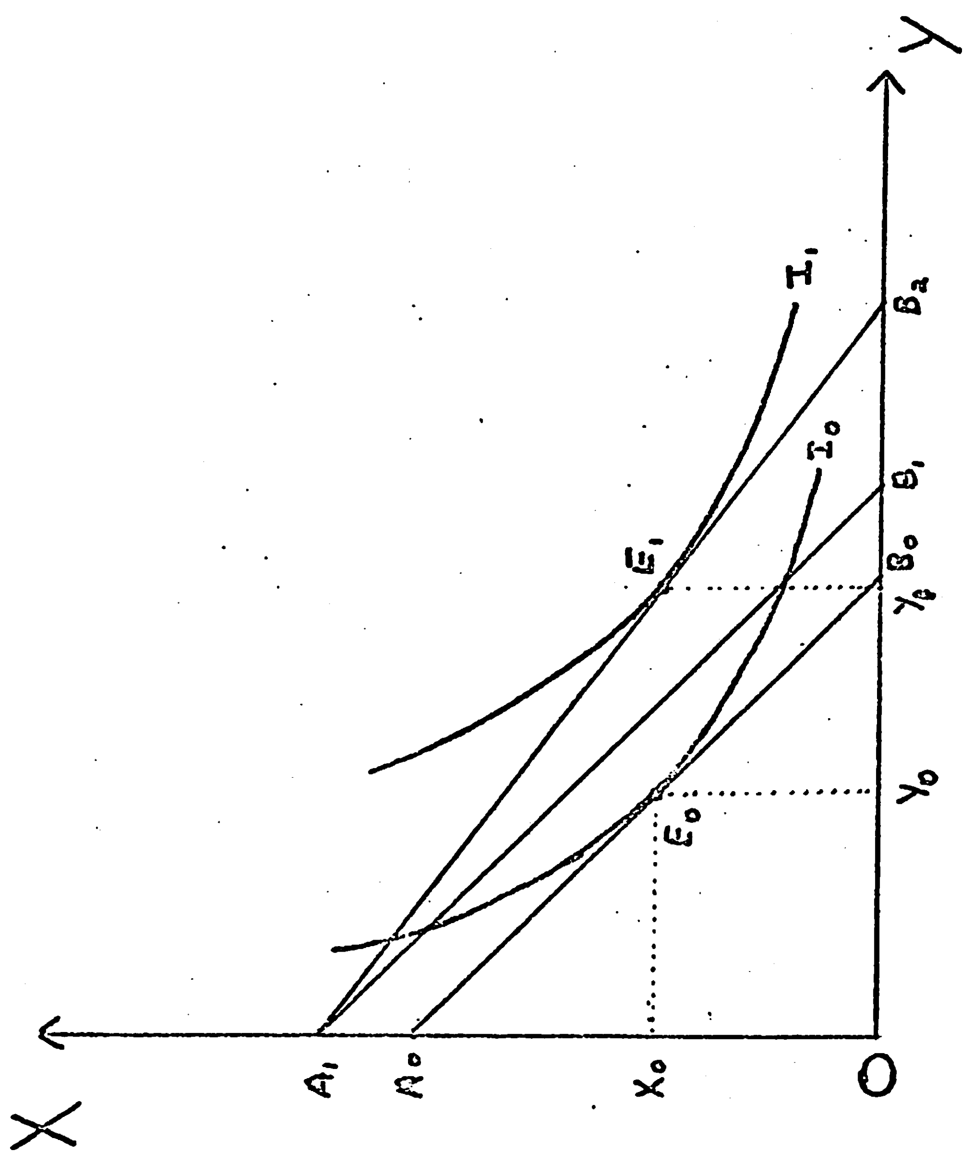


Figure 2

providing an unconditional grant (represented by budget line A_1B_1, parallel to and above A_oB_o by the amount of the unconditional grant) and a conditional grant represented by budget line A_1B_2. The conditional (matching) grant in figure 2 is set at a percentage equal to $\frac{B_1B_2}{OB_1}$. By dealing with each province separately under the guise of "development plans" Ottawa has, in theory at least, the ability to move the various provinces to different points along the P'F' spectrum and thus render the policy strategy more consistent with the objective function.16/

While one can say that overall policy is inappropriate with respect to such policies as industrial incentives, it is hard to fault the richer provinces. They are simply acting in accordance with their own interests and within the bounds of responsibility allotted to them. In large measure it appears that the objective function is simply inconsistent with the patterns that have evolved relating to the powers and responsibilities of the two levels of government. Currently this situation is probably most apparent in the area of social welfare policies. More and more, Canadians are looking to Ottawa for a comprehensive poverty program so that eradication of poverty is quickly becoming a national goal. And given that inadequate aggregate demand is probably the primary cause of poverty there exists an economic rationale for assigning responsibility in this area to the Feds since stabilization policy is under the jurisdiction of Ottawa. Yet the constitutional responsibility of dealing with Canada's poor rests primarily with

---

16/ The reader will realize that there are a multitude of nasty problems connected with drawing inferences from an analysis based on the use of community indifference curves. We simply ignore these problems.

the provinces. This separation of political or economic responsibility from constitutional responsibility can lead to inefficient and even counter-productive legislation. For example, we think a case can be made that the provision in the recently passed Unemployment Insurance Act (which provides for extended benefits in high-unemployment areas) reflects not so much an underlying philosophy that extended benefits in these areas are an essential part of a good unemployment insurance scheme but rather a desire by Ottawa simply to pump extra funds into the depressed areas of the nation. Uncertain as to its ability to effect these transfers within the context of its various social assistance schemes, the federal government elected to make them via a constitutionally acceptable vehicle, namely Unemployment Insurance. We have argued elsewhere that these special privileges to high-unemployment areas will tend to encourage "perverse" migration and work against optimal resource allocation in Canada. A more appropriate vehicle for such transfer payments is as part of an integrated and coordinated (federal and provincial) legislative package in the poverty area.[17/]

This brings us to the role of the Constitution and the whole question of Constitutional revision. Is the BNA Act an exogenous factor in Canadian policy formulation or can it be altered so as to remain consistent with the goals of Canadian policy? We believe the latter approach to be the appropriate one even though one must recognize that constitutional reform is proving to

---

17/ For an elaboration of these points, see Courchene, *op. cit.* For a fuller analysis of the poverty issue including a discussion of the role of the Constitution as it impinges on legislation in the welfare area, see Thomas J. Courchene, "Some Reflections on the Senate Hearings on Poverty", Research Report 7118, Department of Economics, University of Western Ontario, London 72, 1971.

be a lengthy exercise. Furthermore, if the critical problem facing our Confederation is an economic one -- that of disparate provincial levels of income and growth -- then it seems only too obvious that the revision of the Constitution should have an economic focal point. Clearly, Canada will be in for considerable trouble if its agreed-upon national goals or objectives are unable to be achieved or achieved only in a very inefficient manner because of the constraint imposed by the BNA Act.

V. An Alternative Approach

Our approach in this paper has been the two-stage procedure of (a) viewing some alternative objective functions for Canada and (b) then focussing on the various strategies for carrying out the selected objective function. There are other ways of addressing the issue -- ways which put more emphasis on the role of the junior governments. For example, the objective function may be to maintain Canada as a nation with the constraints being that the ten provincial preference functions be satisfied. Faced with inconsistent constraints, the role of the national government is either to (a) render the provincial constraints consistent with the overall objective of preserving Canada either by various types of federal policy (including the use of conditional grants) or some sort of political pressuring or (b) to engage in Constitutional reform such that the existing set of provincial preferences becomes consistent with Canadian unity, or (c) some of both. There are some advantages to this type of approach. First of all, it may be a more realistic description of the political economics of Canadian federalism. Relatedly, and perhaps more importantly, it tends to emphasize two salient features of our federation; (1) provincial preferences for the accepted goals of economic policy (e.g., full employment, price stability) may differ, and (2) even if they are identical, the structure of the provincial economies (i.e., openness, endowments, union power, etc.) may and do imply that not all provincial preference functions can be satisfied simultaneously. For example, not all provinces will currently share Ottawa's concern with inflation because, while the preferences of each province for inflation and employment may be quite similar, the actual trade-off between the two varies considerably from province to province. This type of approach to Canadian policy brings out clearly one problem with the Canadian federation; the difficulty of getting Ottawa to accommodate the preferences of all the provinces, especially the smaller provinces. But this is just another way of expressing the fact that the objective function chosen may be inconsistent with the strategy for implementing Canadian regional policy.